Supreme Court of the United States

UNITED STATES NATIONAL BANK IN JOHNSTOWN and
FIRST NATIONAL BANK OF SOUTH FORK,
Petitioners,

vs.

THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK,
Respondent, and LESTER LARIMER, Trustee.

RESPONDENT'S BRIEF

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RESPONDENT'S BRIEF

Opinions Below

The opinions of the Circuit Court of Appeals, Third Circuit, are reported in 155 F. (2d) 755.

The opinions of the District Court are reported in 56 F. Supp. 190 and 61 F. Supp. 151.

Statement

A voluntary petition in bankruptcy was filed herein on July 10, 1926 by Harvey C. Stineman, the bankrupt, and the matter referred to a referee. On January 8, 1927, petitioner, United States National Bank in Johnstown (herein referred to as the Johnstown Bank), filed a claim in the amount of $10,000. This was apparently intended as a secured claim, since although it recited at one point that the Johnstown Bank had not "received any manner of security whatever, * * * nor has any judgment been rendered thereon", it also recites a judgment against the debtor (R. 8).

A claim was also filed by petitioner, First National Bank of South Fork (herein referred to as the South Fork Bank), on June 29, 1926 in the amount of $18,463.45 (R.

14). This claim recites three judgments rendered against the bankrupt in the respective amounts of $11,290, $5,520 and $1,653.45 (R. 25). The last two judgments were entered within four months of the bankrupt's petition herein (R. 12). It is only on the $11,290 judgment that the South Fork Bank has asserted a lien upon the real property of the bankrupt.

Thereafter and on July 14, 1932 the Johnstown Bank filed a claim designated as "amended liquidated claim" for $13,685 (R. 9). The difference in the amount of its original claim and the "amended liquidated claim" in the sum of $3,685 represented interest accruing after bankruptcy on the aforementioned judgment of $10,000. The question of the right to claim for accrued interest was decided adversely to petitioner (R. 24, 25) and is not involved here.

General claims in this estate amount to approximately $225,000. Among these is the claim of respondent, The Chase National Bank of the City of New York, in the amount of $55,231.98. This claim, in its present amount, was allowed on May 14, 1935 after a reduction from the original claim which was secured in part by collateral. The reduction was ordered upon exceptions filed by the Johnstown Bank and the South Fork Bank.

Among the assets of the bankrupt estate was an undivided one-sixth interest in certain coal lands. Petitioners in their brief (pp. 2, 15) say that the value of this asset was appraised and fixed in the sum of $90,000. The record, however, fails to show that any such appraisal or valuation was ever made. In fact, petitioners indicate that this asset may have been worth even less than the total amount of their combined judgment liens of $21,290 when at page 23 of their brief they state:

> "* * * if the lien creditors had foreclosed upon the liens and securities, there would have been little, *if anything*, left for the general creditors." (Italics added.)

Petitioners' Participation in General Distribution

Since the filing of their claims both the Johnstown Bank and the South Fork Bank have participated in the distribution of the general assets of the estate, and have accepted seven separate dividends. The Johnstown Bank participated on the basis of $13,685, the amount of its "amended liquidated claim" and the South Fork Bank on the basis of $18,463.45. In addition to the dividends from the general estate the Johnstown Bank also accepted, at various times, payments from the sale of real estate in the total amount of $3,003.41 (R. 46-47).

The alleged judgment liens of the Johnstown Bank and the South Fork Bank were never valued or credited in this proceeding. The answer of the Johnstown Bank admits

> "that the value of the lien of said judgment against the bankrupt's real estate has never been fixed . . ." (R. 16.)

This admission explicitly contradicts the statement at page 15 of petitioners' brief that:

> "The apparent value of the securities of the first and second judgment lien creditors must have been determined at the very outset, and this by agreement between such lien creditors and the trustee, and the attorney for the trustee."

The South Fork Bank filed no answer.

Petitioners assert that by agreement they were permitted to participate in distributions from the general funds to the full amount of their claims and at the same time to retain their security. This alleged agreement, they claim, arose from the following statement made by Mr. Little, attorney for the trustee and some of the creditors at a meeting held on December 31, 1929:

> "By Mr. Little: It was at the suggestion of myself, I think, that the order was made to pay this money to

the first judgment creditor, with the thought that the two judgments which were liens on real estate being out of the way, we would have a clear sailing for prorated dividends thereafter. My clients, after the suggestion was made, decided that they could not acquiesce in the suggestion, and requested me to file exceptions, which I was obliged to do. After discussing this with Mr. Keefe, and going over the matter generally, and after examining two of the leases from which the royalties were obtained in order to make up part of the fund for distribution, we suggested that under the law the estate should be divided into two items; one item showing funds arising wholly from real estate which does not include any of the leases or the funds from any of the leases; the other fund should be made up of all royalties, rentals, or dividends on stocks or bonds. The first fund to go to the first judgment creditor, the second fund to be divided pro rata among all the creditors." (R. 43-44)

Mr. Little's statement was vague and susceptible of various interpretations, and it is not clarified by the record as a whole, which was characterized by the Circuit Court as "incomplete and chaotic" (R. 68).

Petitioners' statement (Pets.' Br., p. 4) that the trustee and all creditors assented to Mr. Little's suggestion and "agreed and stipulated" that the judgment creditors' liens were to remain intact while the lienors participated pro rata with general creditors is not supported by the record. On the contrary, not all creditors were present when the statement was made (R. 57) and the record fails to show that any vote was ever taken by creditors as to the alleged method of distribution or that any order sanctioning such method was ever entered.

Questions Presented

1. Do judgment lien creditors in bankruptcy proceedings waive their security where they file claims for the

full amount of their debts and accept dividends based thereon without first having their security valued and credited?

2. In a bankruptcy proceeding, is it inequitable to permit judgment lien creditors to participate in distributions from the general estate to the full amount of their claims and at the same time retain their entire security?

3. Is an agreement valid under the Bankruptcy Act which permits judgment lien creditors to share in distributions from general assets based on the full amount of their claims and at the same time retain their security? If so, does the record herein disclose such an agreement?

4. Are general creditors estopped from claiming, after several dividends have been paid, that secured creditors waived their security by accepting such dividends based on the full amount of their claims without having first had their security valued and credited?

POINT I

Where a creditor files a claim for the full amount of his debt, and accepts dividends based thereon, he waives any security he might have had.

Section 65 of the Bankruptcy Act (11 U. S. C. A. 105) provides in part as follows:

> "a. Dividends of an equal per centum shall be declared and paid on all allowed claims, except such as have priority or are secured."

Section 57h of the Bankruptcy Act (11 U. S. C. A. 93h) permits secured creditors to have the value of their securities determined, the amount of such value credited upon their claims and dividends paid, *only* on the unpaid balance. Prior to 1938 that Section read as follows:

> "h. The value of securities held by secured creditors shall be determined by converting the same into money according to the terms of the agreement pursuant to which such securities were delivered to such creditors, or by such creditors and the trustee by agreement, arbitration, compromise or litigation, as the court may direct, and the amount of such value shall be credited upon such claims, and a dividend shall be paid only on the unpaid balance."

Thus the Bankruptcy Act does not permit a secured creditor to claim ownership of a charge against some specific fund or property on which he could realize all or part of the amount of his claim and at the same time look to the general assets of the estate to liquidate the same debt. The security must first be valued and credited before participation in distributions from the general estate is permitted and dividends may be paid *only* on the balance.

The policy behind the Bankruptcy Act has been set out by this Court in *American Surety Company* vs. *Bethlehem Bank*, 314 U. S. 314, 319n, where it said:

> "Reflecting the special policy of bankruptcy legislation favoring the general creditor against the secured creditor, the rule prevails in bankruptcy that dividends upon the claims of secured creditors 'shall be paid only on the unpaid balance.' "

There is no dispute here that the Johnstown or South Fork Banks failed to have the value of their alleged security determined as provided by Section 57 of the Bankruptcy Act. By accepting dividends on the full amount of their claims, these two banks elected to take their place with unsecured creditors and share ratably with them. The effect of such election is a waiver of security.

In *In re O'Gara Coal Co.*, 12 F. (2d) 426 (C. C. A. 7th, 1926), cert. den. 271 U. S. 683 (1926), the Court said:

> "The provision and purpose of the law is that those having security shall, in the manner provided by the

> statute, get the benefit of that security, but must do so at the expense of reducing the claim upon which they are entitled to participate as a general creditor in the funds of the estate, * * *. When one has two inconsistent remedies and elects to pursue one, he abandons the other. * * *" (p. 429)

In *In re Fisk & Robinson*, 185 Fed. 974, the Court held that the filing of a claim against a bankrupt's estate and the receipt of dividends thereon is a waiver of the creditor's security. There the Court at page 975 said:

> "It is quite true that to file a claim is to waive security (Ansonia Brass & Copper Co. *v.* Babbitt, 74 N. Y. 395), for one may not collect dividends upon the whole debt and then take security upon a part. The rule is similar to that which confines a broker's customer to his election between his claim and his stocks. Re Berry, 174 Fed. 409, 98 C. C. A. 360. Had the claimant actually received dividends, the question would be clear. Nor does it matter, I think that the funds are separate, as the referee suggests; for the waiver operates, whether the claim to the security arises in the bankruptcy court or out of it. Ansonia Brass & Copper Co. *v.* Babbitt, supra. It is enough that the claimant should have elected not to assert his security, and that election would be signified by going ahead upon a claim for full dividends."

In *In the Matter of Florence Pruner Young, Bankrupt*, 9 Am. B. R. (N. S.) 544, the Court refused to permit an amendment of an unsecured claim after the receipt of a dividend thereon to show that it was secured, on the ground that the creditor, having pursued the full amount of its claim and having been paid dividends thereon, had elected its remedy.

In *First National Bank* vs. *Exchange National Bank*, 179 App. Div. 22, modified in other respects 226 N. Y. 633, the Appellate Division held that the acceptance of dividends was a waiver of security.

To the same effect:

In re Burr Mfg. & Supply Co., 217 Fed. 16;

In the Matter of Cann, 47 F. (2d) 661;

In re Ballance, et al., 219 Fed. 537;

Ansonia Brass and Copper Co. vs. *Babbitt*, 74 N. Y. 395;

Merchants' Nat. Bank of Syracuse vs. *Comstock*, 55 N. Y. 24;

Elston vs. *Rusch*, 229 N. W. 503 (Mich.);

Hewitt vs. *Hayes*, 91 N. E. 332 (Mass.).

In rejecting the contention that in a Section 77 Reorganization Proceeding a secured creditor might prove in the general estate the full amount of his claim and reserve his security against any deficiency, the Court in *New York Trust Co.* vs. *Palmer*, 101 F. (2d) 1 (C. C. A. 2nd, 1939), speaking through Judge LEARNED HAND, said:

> "* * * The proceeding is in bankruptcy, not in equity, and the uniform practice in bankruptcy has been to deduct the security from the debt. * * * Nor are we impressed with the superior justice of the 'equity' doctrine. It appears to rest upon the notion that insolvency should not disturb a secured creditor's privilege to go first against the debtor, reserving the security for any deficiency. However, a secured creditor knows at the outset that, insofar as his security will not cover him, he must go pari passu with unsecured creditors; and to that extent he accepts the risk of insolvency. As long as the debtor remains solvent, he may exercise his privilege without disclaiming that acceptance; but to allow it in insolvency, is to give him a preference among the very class with whom he had agreed pro tanto to share equally. This is the justification for the 'bankruptcy' doctrine, * * *." (p. 3)

Petitioners at page 19 of their brief cite three cases, none of which supports their position. *Wuerpel* vs. *Commercial Germania Tr., etc.*, 238 Fed. 269 (C. C. A. 5th,

1916) and *Horton* vs. *Queens County Mach. Corp.*, 166 N. Y. S. 662 are clearly distinguishable from the case at bar since the Courts in those cases were concerned with the rights of preferred creditors rather than those of secured creditors. *Moreover,* in the *Horton* case, all the creditors and the trustee concurred in the method of distribution, and entered into a written stipulation permitting the preferred creditor to accept dividends "without prejudice". These elements are not present here. In that case credit was also given for dividends received. The third case cited by petitioners, *In re Grive,* 153 Fed. 597, supports respondents rather than petitioners. In that case the Court specifically held that under the Bankruptcy Act it was necessary for secured creditors either to surrender their liens or have the same valued and credited before they could participate in distributions as general creditors.

In the present case, the Circuit Court pointed out many courses available to the petitioners under which they could have fully protected their claims (R. 66). In criticizing the procedure followed by petitioners, the Circuit Court stated:

> "The parties have demonstrated, as we have indicated, a complete disregard for the pertinent provisions of the Bankruptcy Act. Those provisions were not intended by Congress to apply only to certain individuals or under certain circumstances. Congress intended the provisions of the Act to be of universal application and to establish principles which Congress deemed necessary for the public good. The participants in Stineman's bankruptcy proceedings were bound by the law. National Bank in Johnstown and South Fork Bank may not receive the benefits of their securities and also be treated as general creditors to the full extent of their claims. They may not have the benefit of both positions and the liabilities and obligations of neither. Under the law an attempt to assert an estoppel against Chase or any other creditor which would effect such a result is futile." (R. 67)

POINT II

It is inequitable for a secured creditor to participate in a distribution of dividends based on the full amount of his debt and at the same time retain his security with the advantages as to interest which such a position may entail.

In *Vanston* vs. *Green, et al.*, decided December 9, 1946, this Court said (slip opinion, p. 4):

> "A purpose of bankruptcy is so to administer an estate as to bring about a ratable distribution of assets among the bankrupt's creditors. * * *"

After the filing of a petition in bankruptcy there is an inevitable delay in distribution. This is the act of the law and is necessarily brought about in order to protect the estate for the benefit of all interests involved. Such delay, however, should not be the occasion "for anyone to gain an advantage or suffer a loss" (*Vanston* vs. *Green, et al., supra*). The aim is to retain claims of the various classes in the same proportion as they were at the time of the filing of the petition, as if "the whole matter could be settled in a day by a pie-powder court": *Sexton* vs. *Dreyfus*, 219 U. S. 339, 344-345. Advantages to a creditor or class of creditors are consequently not permitted and their recoveries are limited, as provided by the Bankruptcy Act.

If a secured creditor were permitted to accept dividends from the general estate based on the full amount of his claim and still retain his security, he would obtain a greater proportion of the assets than he had at the time of the filing of the petition if the estate diminishes or remains the same. Indeed, since a secured creditor might obtain as much interest on his claim after the filing of the petition as can be satisfied out of the secured property, *Coder* vs. *Arts*, 213 U. S. 223, 245; *Ticonic Bank* vs. *Sprague*, 303 U. S. 406, 414, he would receive a greater proportion of the estate even if the estate increases so long as it does not increase more than the amount of interest paid. This alone

is ample reason why a secured creditor is required to have his security valued and credited before he participates in the general estate. Were the rule otherwise, secured creditors could speculate without incurring risk or obligation and to the possible disadvantage of general creditors. As the Circuit Court said in speaking of the secured creditors, "They may not have the benefit of both positions and the liabilities and obligations of neither" (R. 67).

POINT III

The record discloses no agreement to vary the provisions of the Bankruptcy Act, nor can such an agreement be effective.

The Circuit Court held that even if an agreement of the kind claimed by petitioners had been made it would not be effective to vary the provisions of the statute (R. 67n). This position is in accord with the general policy of the Bankruptcy Act. The "theme" of the statute has been repeatedly stated to be equality of distribution. *Sampsell vs. Imperial Paper and Color Corp.*, 313 U. S. 215, 219.

Petitioners' contention that an agreement was made whereunder they could participate to the full extent of their claims and at the same time retain their entire security is without record support. There is no written instrument to which petitioners can refer, nor does it appear that any vote was ever taken by creditors as to the alleged method of distribution or that any order sanctioning such method was ever entered. In addition, it affirmatively appears that some creditors were absent when Mr. Little made his statement at the meeting of December 31, 1929 (R. 57).

Mr. Little's statement, indefinite as it is, is far from even recommending, much less authorizing, the unusual distribution now asserted to be its outgrowth. He merely stated that a "suggestion" was made as to the disposition of the fund held by the trustee which included income from the sale of realty and income from personalty. It does not

appear that he was suggesting a disposition that would circumvent the provisions of the Bankruptcy Act. On the contrary, the fact that it was suggested that the funds held at the time by the trustee be divided into two items, "one item showing funds arising wholly from real estate * * *; the other fund should be made up of all royalties, rentals, or dividends on stocks or bonds," discloses an intention that the judgment lien creditors were to receive the funds arising from real estate against which they asserted their liens and general creditors were to receive the income from personalty. This must follow from the fact that the suggested division resulted after some of the creditors "decided that they could not acquiesce in the suggestion" that the entire fund be paid to the first judgment creditor. There is nothing in Mr. Little's statement as to the lack of necessity for a valuation.

Indeed a possible interpretation of Mr. Little's statement is that a valuation according to the statute was contemplated. The funds arising from the realty would then go to the judgment creditors to liquidate the value as thus established, while the proceeds of the personalty would be divided among the general creditors, including the Johnstown and South Fork banks only to the extent that there was an unsecured balance (as there must necessarily be in the case of the South Fork Bank, since its total claim of $18,463.45 includes only one judgment under which it has asserted a lien—to wit, the judgment for $11,290). However, when both judgment creditors, without valuation or deduction, accepted dividends based upon the full amount of their respective claims, the general creditors were justified in assuming that the judgment creditors decided to waive their security.

No reason appears in the record, nor can it be gathered from Mr. Little's statement, that the general creditors ever intended an indefinite delay in the valuation of petitioners' liens and the possible accumulation of interest over a period of approximately twenty years. Indeed, there would be no reason for general creditors to permit the indefinite

running of a higher rate of interest than generally obtainable with a resultant decrease in the ultimate amount general creditors would receive. The only ones to profit by such a delay are the judgment lien creditors. As this Court has pointed out in *Vanston vs. Green, et al., supra,* the period of delay cannot be the occasion "for anyone to gain an advantage or suffer a loss".

It cannot be assumed that an agreement was made, or even contemplated, which on its face is clearly inequitable and without statutory sanction. Mr. Little's statement is indefinite and no other circumstances are present which establish the alleged agreement. Petitioners may have considered it a better speculation to participate as general creditors rather than rely on their security. In their brief, on page 23, they say:

> "• • • if the lien creditors had foreclosed upon their liens and securities, there would have been little, *if anything,* left for general creditors." (Italics added.)

thus implying that the value of the real estate, upon which they asserted liens, was insufficient to cover the full amount of their claims. Moreover, while it must remain uncertain what doubts may have motivated petitioners, the very fact that they proved and filed their claims implies an expectation that the security would satisfy only part of their debts and that there must be participation in the estate with general creditors for the unsecured balance. (3 Collier on Bankruptcy, § 57.07, p. 157.)

The making of an agreement of the kind here claimed is likewise not supported by the fact that respondent or any other creditor did not question the acceptance of dividends by petitioners until after several were paid. Nor does such failure show laches or create estoppel, as petitioners contend. (Pet. br., p. 20 et seq.) Such a contention overlooks the fact that the unsecured creditors had a right to assume that the Johnstown and South Fork Banks were relying upon the general fund for the payment of their claims. It was not incumbent upon them to determine

what motivated the judgment creditors in pursuing the course they did. Estoppel operates against the one who made the choice and upon which the others had a right to rely. Silence on the part of the unsecured creditors cannot change the fact that an election was made. This election is now final and binding upon the judgment creditors. *In re O'Gara Coal Co.*, 12 F. (2d) 426, cert. den. 271 U. S. 683; *In re Fisk & Robinson*, 185 Fed. 974; *In re Young*, 9 Amer. B. R. (N. S.) 544.

In conclusion it is submitted that even if, under some conditions, creditors might be permitted to agree on a method of distribution which is a departure from that directed by the act, surely this case is not one where such conditions exist. Petitioners would at least have to show (1) that an agreement was actually made and entered into by all parties involved; (2) that it clearly and unequivocally departed from statutory procedure, and (3) that its terms were sufficiently definite to permit enforcement. From the foregoing discussion it appears that all three of these requisites are lacking.

CONCLUSION

The order appealed from should be affirmed in all respects.

Respectfully submitted,

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SUPREME COURT OF THE UNITED STATES

No. 371.—October Term, 1946.

United States National Bank in Johnstown and First National Bank of South Fork, Petitioners, v. Chase National Bank of the City of New York and Lester Larimer, Trustee.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[April 14, 1947.]

Mr. Justice Murphy delivered the opinion of the Court.

A problem arising under the Bankruptcy Act is presented by the unique facts of this case.

On June 10, 1926, Harvey C. Stineman was adjudicated a bankrupt upon a voluntary petition and the case was referred to a referee. The principal asset of the bankrupt estate was an undivided one-sixth interest in a large acreage of valuable coal lands, a large portion of which was operated by lessees and was producing substantial royalties. The value of the interest of the bankrupt estate in this asset is alleged to have been appraised at $90,000.

More than four months prior to the date when the petition was filed and the adjudication made, the United States National Bank of Johnstown, Pa., and the First National Bank of South Fork, Pa., had procured judgments against Stineman. These two judgments constituted first and second liens, respectively, on Stineman's interest in the coal lands. This interest had no other encumbrances upon it.

On January 8, 1927, the Johnstown bank filed its secured claim in the bankruptcy proceedings in the amount of $10,000, reciting as its security the first lien on the interest in the coal lands. This claim was allowed. Subse-

quently, in 1932, the Johnstown bank filed an amended claim in the amount of $13,685, interest accruing after bankruptcy having been added to the original claim. The amended claim was allowed in the amount filed and formed the basis for the bank's participation in the dividends from the general fund, mentioned hereinafter. A court order in 1944 reduced this claim to $10,000.

The South Fork bank, on June 29, 1926, filed its secured claim with the referee for $11,290, reciting the second lien as its security, along with unsecured claims for $7,173.45. Dividends from the general fund were subsequently paid to the bank on the basis of the full amount of all its claims, $18,463.45.

Numerous general, unsecured claims were filed by other creditors, approximating $225,000 in amount. Included among these was the claim of the Chase National Bank of the City of New York, a claim which was allowed in the amount of $55,231.98.

The referee held a meeting of the creditors on December 31, 1929, more than three and a half years after the adjudication. The motive for this meeting appears to have been the fact that the Johnstown and South Fork banks, the judgment lien creditors, were pressing for payment of their secured claims. This meeting was attended by the bankrupt, the trustee in bankruptcy and representatives of the two judgment creditors, the Chase National Bank and certain other general creditors. Apparently not all of the general creditors appeared at this meeting. The consensus of opinion among those present was that the real estate had a value in excess of the liens but that "if the lien creditors foreclosed upon their liens, little, if anything, would be left for general creditors."

One of the attorneys present, P. J. Little, then made a suggestion. Mr. Little at this time was serving as counsel for the trustee, the Chase National Bank and several other general creditors. His suggestion was "that

under the law the estate should be divided into two items; one item showing funds arising wholly from real estate which does not include any of the leases or the funds from any of the leases; the other fund should be made up of all royalties, rentals, or dividends on stocks or bonds. The first fund to go to the first judgment creditor, the second fund to be divided pro rata among all the creditors."

The parties apparently agreed to this proposal. Although no supporting order of the referee appears in the record, the administration of the bankrupt estate proceeded as if a supporting order had been entered. The two judgment lien creditors assented to this course of events and it is asserted that all the creditors understood that the liens were to remain intact until the underlying claims had been paid in full.

Thereafter, four dividends were declared and distributed from the real estate fund, while seven dividends were declared and distributed from the general fund. The Johnstown bank received at least $1,364.76 from the real estate fund; the South Fork bank appears to have received nothing from that fund. Both of these banks shared with the other creditors in the seven distributions from the general fund, the Johnstown bank receiving $2,435.06 and the South Fork bank, $3,285.35. No exceptions were ever taken to any of the various orders of distributions. In addition, these two banks have carefully revived their judgments during each five year period, making the trustee in bankruptcy a party to the proceedings.

In October, 1942, the Chase National Bank filed petitions for a decree to the effect that the two banks had waived their liens by sharing in the distributions from the general fund along with the general creditors and that the Johnstown bank should be compelled to return the $1,364.76 it had received from the real estate fund. The referee, however, held that both the Johnstown and South

Fork banks were entitled to maintain their positions as lien creditors and at the same time participate in the distributions from the general fund. The District Court reversed the referee's decision, feeling that participation in distributions from both the real estate and general funds was contrary to accepted bankruptcy practice. *In re Stineman*, 56 F. Supp. 190. On rehearing, the District Court changed its mind; it became convinced that the Chase National Bank had recommended the arrangement, had acquiesced in its execution and was now estopped from objecting. *In re Stineman*, 61 F. Supp. 151. The Third Circuit Court of Appeals reversed, holding that the parties had completely disregarded the pertinent provisions of the Bankruptcy Act and that the Johnstown and South Fork banks had waived their liens and were entitled to share in the bankruptcy estate only as general creditors. *In re Stineman*, 155 F. 2d 755.

Sections 65 (a) and 57 (h) of the Bankruptcy Act are the ones pertinent to this case. Section 65 (a) provides: "Dividends of an equal per centum shall be declared and paid on all allowed claims, except such as have priority or are secured." 11 U. S. C. § 105 (a). Section 57 (h) provides: "The value of securities held by secured creditors shall be determined by converting the same into money according to the terms of the agreement pursuant to which such securities were delivered to such creditors or by such creditors and the trustee, by agreement, arbitration, compromise, or litigation, as the court may direct, and the amount of such value shall be credited upon such claims, and a dividend shall be paid only on the unpaid balance. Such determination shall be under the supervision and control of the court." 11 U. S. C. § 93 (h).

Under these provisions, there are several avenues of action open to a secured creditor of a bankrupt. See 3 Collier on Bankruptcy (14th ed.) pp. 149–157, 255–259. (1) He may disregard the bankruptcy proceeding, decline

to file a claim and rely solely upon his security if that security is properly and solely in his possession. *In re Cherokee Public Service Co.*, 94 F. 2d 536; *Ward* v. *First Nat. Bank*, 202 F. 609. (2) He must file a secured claim, however, if the security is within the jurisdiction of the bankruptcy court and if he wishes to retain his secured status, inasmuch as that court has exclusive jurisdiction over the liquidation of the security. *Isaacs* v. *Hobbs Tie & Timber Co.*, 282 U. S. 734. (3) He may surrender or waive his security and prove his entire claim as an unsecured one. *In re Medina Quarry Co.*, 179 F. 929; *Morrison* v. *Rieman*, 249 F. 97. (4) He may avail himself of his security and share in the general assets as to the unsecured balance. *Merrill* v. *National Bank of Jacksonville*, 173 U. S. 131; *Ex parte City Bank*, 3 How. 292, 315.

Section 57 (h) is a codification of this fourth possibility. It permits the secured creditor to receive dividends along with the general creditors only on the balance remaining after the value of the security has been determined and deducted from the claim. This rule, commonly known as the bankruptcy rule, is designed to preclude any unwarranted advantage from accruing to the secured creditor. Grounded upon the statutory principle of equality and ratable distribution, it prohibits the secured creditor from reaping the whole benefit of his security while simultaneously taking dividends from the general assets on the basis of his entire claim as if he had no security. This rule differs from the one in equity, which allows the secured creditor to receive dividends on the full amount of his claim, crediting all dividends received and reserving the security against any deficiency. *Merrill* v. *National Bank of Jacksonville, supra.* And see 3 Collier on Bankruptcy (14th ed.) p. 153; Hanson, "The Secured Creditor's Share of an Insolvent's Estate," 34 Mich. L. Rev. 309; 12 Ford. L. Rev. 77.

It is argued that the plan adopted in this case cannot be sanctioned under the foregoing principles. This plan allegedly called for the use of something similar to the equity rule of distribution. The judgment lien creditors were to retain their liens while sharing fully in the dividends from the general funds as if they had no liens, crediting the dividends received against their claims. But § 57 (h) is said plainly to outlaw the use of that rule; if the judgment lien creditors wished to retain their liens, they could share in the dividends only to the extent that their claims exceeded the value of their liens. Since they did not follow the provisions of § 57 (h), the conclusion is reached that they have waived their liens and must now be considered solely as unsecured creditors.

At this point it should be noted that the incomplete record before us fails to reveal the value of the interest in the coal lands to which the liens attached. The judgment lien creditors claim that the value was fixed at $90,000, but no such valuation appears in the record. That it might be less than $90,000 is indicated by the statement of these creditors that if they had foreclosed on their combined liens of $21,290, "there would have been little, if anything, left for the general creditors." But in the setting of this case, we believe it immaterial whether the value of the interest in the coal lands was greater or less than the amount of the secured claims. In either event, the problem before us concerns itself with the present validity of the liens. Has the conduct of the judgment lien creditors been such as to constitute a waiver of their judgment liens? That question we answer in the negative.

The fact that the judgment lien creditors received general dividends contrary to the scheme of § 57 (h) does not necessarily mean that they thereby waived their liens. Nothing in the language of § 57 (h) or of any other section of the Act makes such a receipt the necessary equivalent of a waiver. It is generally true that participation by a

secured creditor in distributions from the general assets on the basis of his full claim indicates a waiver of the security and an election to be treated as an unsecured creditor. See *In re O'Gara Coal Co.*, 12 F. 2d 426. But that is not an invariable result flowing from the application of any rigid statutory rule. The result depends, rather, upon the circumstances surrounding the receipt of the dividends. And in exceptional cases, those circumstances may demonstrate the continued vitality of the security as well as indicate that it would be inequitable to declare the security forfeited. See *Wuerpel* v. *Commercial Germania Trust & Savings Bank*, 238 F. 269; *Maxwell* v. *McDaniels*, 195 F. 426; *Hartford Accident & Indemnity Co.* v. *Coggin*, 78 F. 2d 471; *Standard Oil Co.* v. *Hawkins*, 74 F. 395.

In the rare case where there is reasonable doubt as to whether a waiver has occurred, a careful examination must therefore be made to determine the conditions under which the dividends from the general assets were distributed to the secured creditor. And that examination must be made in the light of the recognized principles of equity. It has long been established that "courts of bankruptcy are essentially courts of equity, and their proceedings inherently proceedings in equity." *Local Loan Co.* v. *Hunt*, 292 U. S. 234, 240; *Pepper* v. *Litton*, 308 U. S. 295, 304. In determining whether a waiver of liens has taken place, the bankruptcy court must accordingly look to the equities involved as well as to the intention of the parties. A waiver may be inequitable or unfair to the secured creditor; the receipt of dividends may not have caused permanent injury to the unsecured creditors; the dividends may have been received under a mistake of law or fact or pursuant to court approval; the objecting party may be estopped from questioning the validity of the liens. Such equitable considerations may well be decisive of a waiver or forfeiture in a particular case.

It is at once evident in this case that the judgment lien creditors received dividends from the general fund in good

faith and without any intent to waive their liens. The principal asset of the estate was the interest in the coal lands and it was that interest to which the liens attached. Representatives of various general creditors believed that it would be to their advantage to have this interest remain intact, without being liquidated in whole or in part in order to satisfy the liens. Their thought was that by maintaining undiminished the royalties and rentals from this interest the unsecured claims could more rapidly be satisfied. To that end it was proposed that the judgment lien creditors refrain from immediate liquidation of their claims and share in the dividends from the general fund, a fund which included the royalties and rentals from the interest in the coal lands. The judgment lien creditors accepted this proposal, being willing to postpone any immediate realization of their security. But they did so with the distinct understanding that their liens were not forfeited and they took pains to renew the underlying judgments every succeeding five years in order to keep the liens alive. There is thus absent any element of an intentional waiver of the liens or any action inconsistent with a desire to retain the liens in the circumstances surrounding the receipt of the dividends by the judgment lien creditors. Cf. *Thomas* v. *Taggart*, 209 U. S. 385; *In re Kaplan & Myers*, 241 F. 459.

Nor do we perceive any equitable reason why these liens should be declared forfeited. The incomplete record in this case does not indicate whether the referee or the bankruptcy court ever gave formal approval to the agreement under which the judgment lien creditors received dividends along with the unsecured creditors. But the bankruptcy proceedings went forward for more than twelve years as if such approval had been given, authorization being given for the distribution of numerous dividends pursuant to the plan. Certainly the agreement had the implied, if not the express, blessing of the referee and the bankruptcy court.

Hence the judgment lien creditors cannot be accused of having participated in a plan which was unknown to, or disapproved by, those responsible for the proper administration of the proceedings. A forfeiture of the liens would only penalize unfairly the judgment lien creditors, who joined the plan in good faith and without any apparent intention of harming others or of securing any undue advantage for themselves.

It is further significant that the plan was proposed by an attorney for Chase National Bank, the general creditor now objecting. Apparently not all the general creditors were present or represented at the meeting on December 31, 1929, when the proposal was made and accepted. But the agreement, with its various dividend distributions taking place between 1935 and 1942, must have come to the attention of all the general creditors sooner or later; yet none of them raised any objection to the various distributions or to the agreement during this long period of time. No reason suggests itself why any of these general creditors should now be permitted to question the dividends received in the past by the judgment lien creditors or to demand that the liens be declared forfeited because of the receipt of such dividends. Especially is this so as to Chase National Bank. As the District Court noted, 61 F. Supp. at 152, its counsel recommended and had full knowledge of the agreement; and Chase had knowledge of the subsequent dividend distributions, to which it did not demur. At this late stage, it is equitably estopped from raising any objection to the validity of the liens on the basis of the operation of the plan which it proposed. Cf. *Merchants Bank* v. *Sexton*, 228 U. S. 634; *In re National Public Service Corporation*, 68 F. 2d 859; *In re American S. S. Nav. Co.*, 14 F. Supp. 106.

Moreover, the record does not indicate that any permanent injury to Chase National Bank or to the other general creditors resulted from the operation of the plan. The whole scheme was adopted with the idea that they would

be benefited and we cannot say that this purpose has failed of achievement. Having proposed and acquiesced in the plan, the Chase National Bank cannot now be heard to complain of any resulting injury, especially an injury that is not apparent in the record.

We conclude from these various considerations that the liens should be held to be valid and in existence despite the failure to follow the provisions of § 57 (h) and despite the distribution of dividends contrary to § 65 (a). There was never any intention to waive the security and those who might have objected to the distributions are now estopped. But in view of the fact that the bankruptcy proceedings have been unduly prolonged for over twenty years, the bankruptcy court should now take steps to wind up the estate in accordance with the provisions of the Bankruptcy Act. Those provisions are designed to bring about the speedy distribution of the bankrupt's assets, a distribution of the type which definitely has not occurred in this case.

The judgment of the Circuit Court of Appeals is reversed and the case is remanded to the District Court for further proceedings consistent with this opinion.

Reversed.

MR. JUSTICE FRANKFURTER is of opinion that the order of the District Court should be restored on the ground that the creditors entered into an agreement which was not objectionable under § 57 (h) of the Bankruptcy Act, whereby the liens of the petitioners were saved.

MR. JUSTICE JACKSON concurs in the result.

MR. JUSTICE DOUGLAS dissents.